

DOCKET FILE COPY ORIGINAL

RECEIVED

SEP 21 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of

REVISIONS TO PRICE CAP RULES
FOR AT&T

)
)
)
)

CC Docket No. 93-197

COMMENTS OF
AMERICAN TELEPHONE AND TELEGRAPH COMPANY

FRANCINE J. BERRY
JOHN J. LANGHAUSER
MICHAEL C. LAMB

Room 3244J1
295 North Maple Avenue
Basking Ridge, New Jersey 07920

Its Attorneys

September 21, 1993

No. of Copies rec'd
List ABCDE

015

TABLE OF CONTENTS

	<u>Page</u>
Summary	i
I. The Commission Should Adopt Its Proposal To Streamline Regulation of All AT&T Optional Basket 1 Services	2
II. Commercial Long Distance Services Should Be Streamlined	10
A. AT&T's Commercial Long Distance Service Classification Has Been In Effect For Over One Year Without Opposition Or Customer Complaints	11
B. AT&T's Commercial Long Distance Service Classification Is Completely Consistent With Commission Precedent and Policy	12
C. AT&T's Waiver Petition Conclusively Demonstrated That Commercial Long Distance Service Should Be Streamlined	18
III. The Commission Should Eliminate The Productivity Offset For Basket 2 and 3 Services	23
IV. The Commission Should Allow AT&T To Implement Improvements In Its Service Quality and Network Reliability Monitoring System	25
CONCLUSION	28

SUMMARY

This proceeding is the second phase of the Commission's scheduled review of the price cap regulation of AT&T. The first phase, the Price Cap Performance Review For AT&T, concluded with a July 23, 1993 report on AT&T's performance under price cap regulation, which found that AT&T's rates for price capped services fell by 21 percent during the past four years, and that AT&T's earnings for capped services were "relatively low."

Despite AT&T's demonstration in the Performance Review that it faces vigorous competition for all of its services, the Notice considers streamlined regulation only for AT&T's optional calling plans and commercial long distance service, as well as other minor changes to price cap regulation. AT&T's comments in this proceeding are limited to the four categories of "modest" price cap rule changes proposed in the Notice.

The first general category of proposed rule changes, the proposal to streamline regulation of AT&T's optional calling plans ("OCPs"), should be implemented without delay. AT&T has repeatedly demonstrated that OCPs -- indeed, all Basket 1 services -- face pervasive competition.

Implementation of OCP streamlining, however, should not take away accrued pricing headroom available

today for AT&T services that will remain in Basket 1. To do so would decrease the pricing flexibility for those services even though the record in the Performance Review established that the services remaining in Basket 1 face more, not less, competition than they did when price caps began. These services should not lose existing pricing flexibility simply because the Commission decides to streamline its regulation of OCPs. After streamlining, of course, subsequent price changes in OCPs would no longer affect the amount of headroom available for services remaining in Basket 1.

After the Commission has removed OCPs and commercial long distance from Basket 1, it should no longer continue to impose a three percent annual productivity offset to the subset of AT&T services which the Commission proposes to retain under price caps. That productivity factor was computed on the basis of average productivity gains for all interstate services and has no direct relationship to the productivity of the basic schedule residential services remaining under price caps.

Instead, the Commission should eliminate the productivity offset, taking yet another "modest" step to eliminate unnecessary regulation. In announcing the changes proposed in the Notice, Commissioner Barrett noted that price caps "were never intended as a permanent basis for regulation of AT&T" and Chairman Quello emphasized that he

would "call for further review of the restraints on AT&T." Consistent with these statements, the Commission, at a minimum, should continue the transition to streamlined regulation of AT&T services by using the overall Basket 1 cap only as a secondary backstop to assure reasonable rates. Under this approach, competition and the price cap service band restrictions (which limit annual price changes for services within a service band to plus or minus five percent) would be the primary assurances of reasonable rates. The overall cap would provide a secondary assurance of reasonable rates and would not need to be fine-tuned by any newly-computed productivity factor.

The Commission also questions the reasonableness of AT&T's commercial long distance service classification and seeks more data concerning the impact of AT&T's proposal to streamline regulation of that service. The commercial service classification is expressly authorized as reasonable by Section 201(b) of the Communications Act. Moreover, AT&T's use of the local exchange carrier ("LEC") customer classifications to identify commercial customers is based on consistent Commission precedent adopting the LEC classifications for similar purposes. For example, the Commission's rules use LEC classifications today to impose end user line charges on business customers.

The Commission also raised the concern whether AT&T was restricting the use or resale of commercial long distance service in a manner inconsistent with the Commission's resale policies. AT&T's tariff does not restrict the use or resale of commercial long distance in any way.

The Notice seeks comment on the price cap treatment of the few services remaining in Baskets 2 and 3. These services, as well as those in Basket 1, no longer warrant price cap regulation. To the extent that such regulation continues, however, the Commission should not impose the productivity offset on these baskets. Basket 3 is composed of analog private line services which use outmoded inefficient technology and do not benefit from productivity gains. Similarly, unlike the communications services on which the interstate productivity factor was based, 800 directory assistance service does not even provide basic communications transport between end users. It provides information.

The Commission dramatically changed the nature of the services in these baskets and therefore should show in this review that its price cap rules remain rational for these modified baskets. The Commission has not established -- and cannot establish -- that analog private line services and 800 directory assistance service experience the same

rate of productivity improvement as do all interstate services on average. By eliminating the productivity offset for these baskets, the Commission would continue the transition to the elimination of price caps for these services and avoid the need for a complex proceeding to establish new productivity factors.

The final issue discussed in the Notice concerns AT&T's plans to fine-tune the basis on which it submits Equipment Blockage and Failure ("EB&F") data to the Commission. These data demonstrate that AT&T's service quality and reliability have improved under price cap regulation. At the Commission's direction, AT&T engaged an independent auditor, Coopers & Lybrand, to audit AT&T's past EB&F submissions. Coopers' report, which is submitted with these comments, identifies no errors in the EB&F data and confirms that AT&T's proposed changes to the EB&F report have a valid statistical basis.

In the Matter of)
)
 REVISIONS TO PRICE CAP) CC Docket No. 93-197
 RULES FOR AT&T)

American Telephone and Telegraph Company ("AT&T")
hereby comments on the Notice of Proposed Rulemaking
released by the Commission on July 23, 1993 ("Notice").¹

This proceeding continues the Commission's scheduled review of the price cap regulation of AT&T, which began with the recently-concluded Price Cap Performance Review For AT&T.² In the Performance Review, AT&T made an uncontradicted showing that all of its services face intense competition and should not be subject to price caps based on the Commission's own criteria.³ Yet, the Commission now

³ Performance Review, AT&T Comments, filed September 4, 1992; AT&T Reply Comments, filed October 5, 1993.

proposes to make only concededly "modest" revisions to the price cap rules.⁴

The Notice discusses four categories of potential rule changes: (1) whether to streamline regulation of AT&T's OCPs currently in Basket 1; (2) whether to streamline regulation of AT&T's commercial long distance service; (3) whether to modify the price cap treatment of the services remaining in Baskets 2 and 3; and (4) whether to accept AT&T's plans to fine-tune the basis on which it submits Equipment Blockage and Failure ("EB&F") data to the Commission. These comments address each of these subjects in turn.

I. The Commission Should Adopt Its Proposal To Streamline Regulation Of All AT&T Optional Basket 1 Services

The Commission concludes in the Notice that "there is substantial reason to consider moving OCPs from Basket 1 and to streamlined regulation" because they face "vigorous competition."⁵ After that removal, the "remaining Basket 1 services would be the basic long distance service, MTS"

⁴ Notice, ¶ 1. Although its comments in this proceeding are limited to the Commission's proposals, AT&T will continue to seek significant regulatory relief for all of its services because they all face pervasive and intense competition.

⁵ Notice, ¶ 4.

(which the Commission notes includes direct-dial and operator-assisted interstate and international calls). Id.

With Basket 1 limited to "basic long distance service," the optional services to be streamlined include: Block-of-Time (i.e., ReachOut America), Area Code Calling Plan, AnyHour Saver, Card Only Plan 1, ReachOut Overseas, USADirect (which provides an option for calls from other countries to the United States), and the optional EasyReach service.⁶ Thus, the services to be streamlined include all services introduced as "new" services under price cap regulation, because such services, by definition, are "options" to AT&T's basic schedule of services.⁷

The record fully supports the Commission's conclusion that these optional services face "vigorous competition."⁸ AT&T's comments in the Performance Review offered overwhelming evidence of such competition: a plethora of competitive offers, significant increasing churn

⁶ The Notice inadvertently lists the Small Business Option as a plan that might be removed from Basket 1 regulation. Notice, ¶ 4. The Small Business Option, which previously was in Basket 3, was streamlined in Docket No. 90-132.

⁷ Section 61.3(s) defines a "new" service offering as one which "enlarges the range of options available to ratepayers." 47 C.F.R. § 61.3(s) (emphasis added).

⁸ Notice, ¶ 3.

of customers between competitors, and readily available excess competitive capacity.⁹ On the basis of this record, the Commission concluded that prices for AT&T's OCPs "already appear to be determined by market forces, not by price cap limits."¹⁰

In light of that uncontradicted competitive showing, there is no reason to consider moving the OCPs to another basket in lieu of streamlined regulation, which the Notice mentions as an alternative rule modification.¹¹ To the contrary, as the Commission noted in its IXC Rulemaking Order,¹² continued price cap regulation of these services would impose significant costs on consumers "by delaying the availability of new services and price reductions." Beyond these direct costs of unnecessary regulation, the Commission has identified several indirect costs, including the costs of denying customers full AT&T "pricing flexibility needed to react to market conditions and customer demands";

⁹ See AT&T Comments, filed September 4, 1992 in Price Cap Performance Review for AT&T, CC Docket No. 92-134.

¹⁰ Notice, ¶ 3.

¹¹ Notice, ¶ 4.

¹² In the Matter of Competition in the Interstate Inter-exchange Marketplace, 6 FCC Rcd. 5880, ¶ 78 (1991) ("IXC Rulemaking Order").

creating "regulatory delays and uncertainty"; "reduce[ing] incentives for AT&T's competitors to 'stay on their competitive toes'"; and "lessening AT&T's incentive to initiate pro-consumer price and service changes."¹³ In short, the Commission has recognized that continued price cap regulation of competitive services such as OCPs would be extremely harmful and should not be considered.

The Commission inquires whether the existing Basket 1 indices, the Actual Price Index ("API") and the Price Cap Index ("PCI"), should be adjusted to reflect the removal of the OCPs.¹⁴ This inquiry raises the issue of whether the existing headroom in Basket 1 should be eliminated as a result of the removal of OCPs from the Basket. Of course, following streamlining, price changes in OCPs would no longer affect the amount of headroom for services remaining in Basket 1.

The Commission should not adjust the API or PCI to eliminate headroom when it streamlines the OCPs. Today, there is \$270 million of unused headroom in Basket 1 which any Basket 1 service, including the basic schedule services, may use. The decision to streamline OCPs is not an event

¹³ IXC Rulemaking Order, ¶ 80.

¹⁴ Notice, ¶ 4.

which should increase the regulatory burdens and decrease flexibility for services that remain in Basket 1. There has been no finding that these services need greater regulatory oversight or less pricing flexibility. To the contrary, the same market forces which prevented AT&T from using all available headroom prior to the OCP streamlining would continue to prevent unreasonable increases after that change. See Notice, ¶ 3 ("pricing below the cap maximum" indicates that services are subject to "competitive price pressure").

For the same reasons, there is no basis for adopting the Commission's suggestion that the APIs for remaining Basket 1 services be reinitialized at 100 as of the date the Commission released the Notice. Notice, ¶ 4. Under that approach, lawful rate increases for remaining Basket 1 services implemented since the Notice's July 23 release date would, retroactively and arbitrarily, be rendered unlawful as a result of an essentially unrelated event: the streamlining of OCPs.

The Notice also seeks general comments on the impact of streamlining OCPs. There no longer is a rational record basis for continuing to impose a three percent annual productivity offset to the subset of AT&T services which the Commission proposes to retain under price caps following this proceeding.

In light of the competitive forces which operate as the principal check on AT&T's prices, there is no longer a justification for application of a productivity factor for the remaining Basket 1 services. The Commission acknowledged in its Notice of Inquiry which commenced the Performance Review that price caps were intended as a "transitional step" in the regulation of AT&T.¹⁵ Similarly, at the open hearing in which the Notice was released, Commissioner Barrett reinforced that price caps "were never intended as a permanent basis for regulation" of AT&T, and Chairman Quello added that he would call for further review of restraints on AT&T and would "support looking at whatever steps we may take to relieve AT&T of unnecessary regulation"16

The purpose of the productivity offset was to ensure that, as a result of price cap reductions required by the offset, consumers benefited from improvements in AT&T's productivity. The Commission acknowledged in the Notice that competition now plays that role, with AT&T pricing Basket 1 services somewhat below the cap.¹⁷ Indeed, the

¹⁵ Notice of Inquiry, Performance Review, ¶ 10.

¹⁶ FCC To Lift Some Price Cap Limits On AT&T, Plans Additional Relief, 10 Common Carrier Week No. 26 (June 28, 1993).

¹⁷ Notice, ¶ 4.

Commission's Report in the Performance Review concludes that price caps should be retained, not because of any finding that AT&T retains actual market power, but because it "may" be premature to replace price cap regulation, which the Commission believes is working well.¹⁸

In these circumstances, the Commission should take yet another "modest" step toward streamlined regulation and eliminate the productivity offset, using the overall Basket 1 cap only as a secondary backstop to assure reasonable rates. Under this approach, competition and the price cap service band restrictions (which limit annual price changes for services within a service band to plus or minus five percent) would be the primary assurances of reasonable rates. The overall cap would be a secondary measure of assurance of reasonable rates and would not need to be fine-tuned by any newly-computed productivity factor.

The Commission can be assured that elimination of the productivity offset would not harm consumers because the same competitive showing on which the Commission proposes to streamline OCPs also established that basic schedule

¹⁸ Performance Review, Report, ¶ 19.

services face vigorous competition.¹⁹ Moreover, to the extent the productivity factor is viewed as a safeguard against excessive earnings, the record in the Performance Review demonstrates that AT&T's earnings from Basket 1 services are, if anything, grossly insufficient.²⁰ There is no material threat that AT&T's Basket 1 rates could result in excessive earnings.

Elimination of the productivity offset would also eliminate the need to undertake the complex analysis necessary to establish a new offset appropriate for the services that would remain in Basket 1. In its discussion of Basket 2, the Commission recognized:

"[T]he price cap productivity factor is based on historical productivity growth for all interstate services. This factor may not necessarily be appropriate for a single small service such as 800 DA."²¹

¹⁹ In the event the Commission subsequently reassessed the need for a productivity offset, it could always reimpose the offset requirement.

²⁰ During the first three years of price cap regulation, AT&T's interstate earnings on Basket 1 services averaged only 8.1 percent, less than two-thirds of the overall interstate rate of return. Basket 1 earnings were 7.0 percent in 1989, 10.0 percent in 1990, and 7.4 percent in 1991. Performance Review, Report, 8 FCC Rcd. 5165, ¶ 10. By comparison, AT&T's overall interstate earnings during this period averaged over 12 percent. Id.

²¹ Notice, ¶ 18 (emphasis added).

As with Basket 2, there is no reason to believe that the historical average overall interstate productivity factor -- which reflects the broad array of switched and private line business and residential services -- is the correct rate of productivity for the basic schedule switched residential services that will remain in Basket 1.²²

If it implements its proposed changes to the composition of Basket 1, the Commission should implement those changes in a reasonable manner and ensure that its existing price cap rules, such as the productivity offset, are not rendered arbitrary. Because the Commission would no longer have a rational, historic basis for the three percent productivity factor, it has two options. It may either compute a new, lawfully-supported productivity factor or it may eliminate the productivity factor. The Commission should adopt the latter option.

II. Commercial Long Distance Services Should Be Streamlined

The Notice seeks to develop a "more complete record" before a decision is made whether to grant AT&T's

²² At the conclusion of this proceeding, the Commission will have removed (if its proposals are adopted) almost all AT&T business services and a significant portion of AT&T's residential services from price cap regulation.

request to streamline commercial long distance service.²³ Specifically, the Notice inquires about the justification for AT&T's definition of commercial long distance service and the impact of that definition on the Commission's resale policies.²⁴ In addition, the Notice seeks more data concerning AT&T's market share computations for commercial long distance services and concerning cost differences between commercial and residential services.²⁵

A. AT&T's Commercial Long Distance Service Classification Has Been In Effect For Over One Year Without Opposition Or Customer Complaints

In July and August 1992, AT&T filed tariff revisions which restructured AT&T Tariffs F.C.C. Nos. 1 and 13 into separate commercial and residential basic schedules for Dial Station calls. That restructuring reflected the materially different nature of the services which AT&T provides to its commercial customers in comparison to the services used by residential customers.

No party opposed the tariff restructure, which became effective in September 1992. Initially, AT&T implemented no permanent differences between the rates for

²³ Notice, ¶ 13.

²⁴ Id., ¶¶ 10-11.

²⁵ Id., ¶ 10.

commercial and residential services. Thereafter, on March 3, 1993, AT&T filed its first permanent rate changes differentiating commercial and residential rates. Those rates, which were filed on 120 days' notice, again were not opposed and became effective on July 1, 1993.²⁶ Most significantly, there has not been a single customer complaint about the separate rate schedules since AT&T established the commercial long distance service classification and varied the rates for that service.

B. AT&T's Commercial Long Distance Service
Classification Is Completely Consistent With
Commission Precedent And Policy

The Notice raises certain questions concerning the reasonableness of AT&T's commercial long distance service classification. First, the Notice inquires why AT&T defines its commercial long distance service by reference to the local exchange carrier class of exchange service.²⁷

Commercial long distance services are defined in AT&T's tariffs as domestic and international "Dial Station

²⁶ Although the changes to the commercial schedule were allowed to become effective, concurrently filed discounts proposed in the residential schedule have been deferred for reasons unrelated to the commercial/residential split aspect of the discounts.

²⁷ Notice, ¶ 10.

calls originated on a line for which the subscriber pays a rate that is described as a business or commercial rate in the applicable local exchange service tariff for switched services."²⁸ AT&T defined commercial long distance service by reference to the local exchange service classification principally because of the strong Commission precedent supporting this approach.

In evaluating NECA tariffs and establishing End User Line Charges that differentiate between commercial and residential customers, the Commission found that it was reasonable to define commercial customers by reference to the local exchange carrier classification. The Commission explained:

"[T]he NECA tariff uses the customer's local exchange tariff status as a residential or business subscriber for purposes of applying subscriber line charges. We continue to believe that this approach is appropriate. Classification of customers as residential or business users in the local exchange tariffs is usually subject to state review like any other term or condition in the local tariffs. If the state commission is satisfied with treating a particular subscriber as a business customer for purposes of the local tariff, we believe that such treatment should be appropriate for purposes of subscriber line charges as well. Having the FCC second guess the state commissions on this point would require

²⁸ See AT&T Tariff F.C.C. No. 1, Section 6.20.

the expenditure of substantial federal resources and would serve no useful purpose."²⁹

Indeed, the Commission held in a related decision "that it would be confusing, and potentially discriminatory, for us to impose different standards for defining residential and business services from those applied by the states."³⁰

Although these decisions arose in the context of rates for interstate access, the Commission's rationale is equally applicable here: having the Commission second guess state commissions on the proper definition of a "business" or "commercial" customer would require the expenditure of substantial federal resources and would serve no useful purpose.

The Commission continues to impose different rates on "business" and "residential" customers and defines these customer classifications by reference to the LEC customer classification. See 47 C.F.R. § 69.104(g) and (h) (End User Line Charges). Moreover, AT&T applies the Commission's separate price cap restriction on increases in rates for

²⁹ In the Matter of MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 57 R.R.2d (P&F) 267, ¶ 45 (1984).

³⁰ Order, In the Matter of Investigation of Access and Divestiture-Related Tariffs; MTS and WATS Market Structure, ¶ 123 CC Docket No. 83-1145; CC Docket No. 78-72, FCC 84-201 (released May 15, 1984).

services "that are purchased by residential customers" by this same definition. See 47 C.F.R. § 61.48(g).

In addition to the strong Commission precedent for defining commercial customers by reference to LEC classifications, AT&T adopted this definition because the LEC classifications could be implemented with great efficiency. Those classifications were already in effect, had been reviewed for reasonableness by state commissions, and were readily available from LEC billing systems.

The second issue raised by the Notice is whether the commercial long distance service offering is inconsistent with the Commission's long-standing positions on the use and resale of tariffed services.³¹ There is no conflict with the Commission's policies. As with its other tariffed services, AT&T does not restrict the use or resale of commercial long distance service. A commercial AT&T customer remains free under the tariff to resell commercial long distance.

To the extent that the Commission's inquiries about cost differences and the consistency of a commercial service classification with the Commission's policies question the legality and reasonableness of even having a

³¹ Notice, ¶ 12.

separate commercial service classification, this question is resolved definitively by the Communications Act. Section 201(b) expressly authorizes a separate "commercial" service classification.³² The statute states that communications subject to the Act may be classified into "day, night, repeated, unrepeated, letter, commercial, press, [or] Government" classes and that "different charges may be made for the different classes of communications" Id. (emphasis added).³³

³² 47 U.S.C. § 201(b).

³³ The Notice comments that AT&T has not submitted data concerning differences in the costs associated with commercial and residential long distance services. See Notice, ¶ 10. In light of the statutory authorization for the commercial classification, cost data should be irrelevant. Nevertheless, there are material cost differences, in part associated with the different demands on AT&T's network from the two classes of service. For commercial long distance, for example, 73 percent of call minutes are during the day rate period, with evening and night/weekend periods accounting for only 16 percent and 11 percent of minutes, respectively. For residential services, the calling patterns are completely different, with day calls accounting for only 19 percent of minutes, while evening and night/weekend account for 47 percent and 34 percent of minutes, respectively. Similarly, other call characteristics such as the average length of calls and the average length of haul vary significantly. There are also several specific cost differences between commercial and residential service. For example, on a per minute basis, commercial long distance billing costs are almost 30 percent higher than billing costs for residential services, reflecting AT&T's direct provision of bill support to many commercial customers. In addition, the customer inquiry costs per minute of use for commercial long distance are significantly higher than for

(footnote continued on following page)

Thus, just as separate Government service classifications have long been accepted as lawful pursuant to this provision in Section 201(b), so too are separate commercial classifications. Moreover, any doubt about the impact of the statutory authorization is eliminated by the Supreme Court's decision in Western Union Telegraph Co. v. Esteve Bros. & Co., 256 U.S. 566, 569 (1921), which held that the predecessor to Section 201(b) "expressly recognized" these enumerated classifications as "just and reasonable."

Significantly, Section 201(b) also expressly authorizes "different charges" for the separate commercial classification, eliminating any argument that the rates for the commercial service classification need to be justified by the different competitive circumstances, customer usage or costs associated with commercial long distance service. Indeed, the Common Carrier Bureau confirmed this interpretation of Section 201(b) in a discussion of the "Government" classification when it "conclude[d] that Section 201(b) is best understood as creating an exception

(Footnote continued from previous page)

residential service. Similarly, commercial long distance marketing and promotion costs per minute are substantially greater than for residential services.

to Section 202(a) by permitting the establishment of government service regardless of whether such service is 'like' other services offered at different rates."³⁴

In short, AT&T's commercial long distance service classification is fully consistent with the Commission's policies, is expressly authorized by the Communications Act, and serves the public interest by allowing AT&T to conform this service offer directly to the needs of the commercial customer group.

C. AT&T's Waiver Petition Conclusively
Demonstrated That Commercial Long
Distance Service Should Be Streamlined

In September 1992, AT&T sought a permanent waiver of the price cap rules for commercial long distance.³⁵ A handful of parties opposed that waiver petition, raising certain questions on which the Commission now seeks a further response from AT&T.

The Commission notes that CompTel challenged AT&T's market share data by claiming that AT&T had

³⁴ AT&T Communications, Inc., Revisions to Tariff F.C.C. No. 16, 5 FCC Rcd. 700, 701 (1990) (Chief, Common Carrier Bureau).

³⁵ AT&T Petition For Waiver of Price Cap Regulations for New Commercial Long Distance Service Classification, filed September 1, 1992, which is incorporated herein by reference.